AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



MARK SCHEME

3.2.2.3 THE DETERMINANTS OF AGGREGATE DEMAND

SCORE	PERCENTAGE
/177	%

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Mark schemes

1.

Relevant issues include:

- definitions/explanations: inflation, cost-push inflation, demand-pull inflation, the general price-level, price indices
- explaining possible causes of rises in demand-pull inflation through an increase in the components of AD such as:
  - increased consumption due to the falling unemployment
  - increased investment due to falling interest rates
  - increased government spending due to a discretionary policy to raise welfare spending, e.g. pensions
  - increased exports due to higher economic growth in a trade partner
  - decreased imports and increased exports due to a depreciation in the currency
  - a rise in the money supply supporting the monetarist view and using the Fisher equation
- explaining possible causes of rising cost-push inflation through an increase in the costs of the factors of production such as:
  - rising wage costs
  - rising raw material costs
  - rising commodity prices such as oil
- explaining external shocks which may impact upon inflation
- explain microeconomic issues which may impact upon inflation such as rising housing costs affecting the RPI measure or possible collusion in energy markets affecting domestic fuel prices
- explaining possible short-run reasons for increases in prices and long-run reasons.

The use of relevant diagrams to support the analysis such as rising AD/AS should be taken into account when assessing the quality of the student's response to the question.

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Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1 – 5 marks**

[15]

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2.

Explanation

For defining investment, for example, that which is spent on capital equipment which can be used to create output and / or improve efficiency.
Investment and its linkage with aggregate demand
Investment as an injection into the circular flow
Investment and human capital
Overseas investment, such as FDI, portfolio investment or investment by multinational companies.
Examples of investment.
Use of technical terms, e.g. gross / net investment; private / social capital; physical / financial capital.
For use of a relevant diagram, e.g. circular flow

Analysis of benefit

Overseas investment spearheading trade links boosting the export sector. Overseas investment can spearhead trade links thus helping to boost the UK export sector. This in turn can be the growth inducing factor for the economy, especially by generating an export multiplier leading to an economic stimulus of the sector.
Stronger international linkages benefiting the balance of payments on current account.
The potential benefits to domestic employment.
Profit, interest, dividends (PID) from overseas investment and uses to which these might be put.
Any other valid analysis.
Use of appropriate diagrams, e.g. AD / AS.
References to the UK economy in the analysis.

[9]

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4.

For candidates who:

Explain

- by first defining the multiplier, eg the amount by which an increase in injections into the circular flow of money will increase total income in the economy
- by referring to the various injections into the circular flow and perhaps providing the contrast with leakages or withdrawals
- by providing a formula or formulae
- the process by relating the multiplier to aggregate demand, GDP etc.

Analyse the impact on unemployment, eg:

- the multiplier may be initiated by an increase in government capital expenditure, eg on road building. This not only creates jobs in the road-building sector but, as these workers begin to spend their income, jobs are also created in other sectors and so unemployment in the economy can be reduced
- exports and job creation
- private sector investment and job creation
- income changes across the economy.

Analyse the impact on economic growth, eg:

- if the multiplier serves its purpose and stimulates AD, by increasing incomes and household consumption, this will stimulate domestic production to some extent and this will cause a rise in actual growth as measured by GDP
- the impact of an investment-induced multiplier on AD and on productive capacity, and hence potential growth
- the impact of an export-led multiplier on AD with the potential for supply-side benefits also
- to the extent that the multiplier process may help sustain AD, it will make it less likely that capacity will be 'destroyed', eg plant being scrapped, and this may have beneficial consequences for future economic growth.

Reward references to the UK / other economies

[9]

6.

Explanation:

Definition: As there is no single definition for this, any suitable definitions can be credited: eg The ability of an economy to sell goods and services in or to other countries and linking to the theory comparative advantage or in terms of lower costs of production or price/non price competitiveness

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Analysis:

For Example: A fall in corporation tax may reduce a firms costs therefore the firms expected profits may rise and improve confidence which may be a catalyst for investment which may increase spending on both human capital and physical capital which may lead to productivity advancements allowing firms to sell goods for cheaper on international markets.
Use of appropriate diagrams, eg AD/AS
Reference to the UK or other economies.

[9]

8.

Relevant issues include:

- lower AD leading to a fall in the price level
- reduction in consumer confidence and spending
- lower business confidence and investment
- price cutting by firms in a period of recession
- recession/deflation in the rest of the world
- falling world commodity prices
- strengthening exchange rate
- technological breakthroughs lowering costs of production
- impact of cheaper imports from low waged economies
- malign v benign deflation

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

[15]

9.

D

[1]

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10.

Level of response	An answer that:	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or good use of data to support the response • includes well-focused analysis with a clear, logical chain of reasoning • includes a relevant diagram that will, at the top of this level, be accurate and used appropriately.	**7-9 marks**
2	• includes one or more issues that are relevant to the question • shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles and/or data to the question • includes some reasonable analysis but it might not be adequately developed and may be confused in places • may include a relevant diagram.	**4-6 marks**
1	• is very brief and/or lacks coherence • shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • demonstrates very limited ability to apply relevant economic principles and/or data to the question • may include some very limited analysis but the analysis lacks focus and/or becomes confused • may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects.	**1-3 marks**

An AS/AD diagram is expected, showing a rightward shift of the AD curve.

Relevant issues include:

- meaning of recovery
- exports as a component of aggregate demand
- impact on output and employment in the export-producing sectors
- export-led multiplier effects
- possible accelerator effects

[9]

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11.

For defining / explaining • Recession • Economic growth • The trade cycle.	**Up to 2 marks per definition or explanation to a maximum of 4 marks**

Award 1 mark for each logical link in the chain of reasoning:

For example Higher unemployment **(1 mark)** much of which will be cyclical unemployment **(1 mark)** due to a lack of AD which causes disposable incomes to fall **(1 mark)** which leads to further negative multiplier effects **(1 mark)** which may mean even less revenue and profits for firms **(1 mark)**. Firms are also likely to be reluctant to hire new staff due to existing spare capacity **(1 mark)** and may just run down existing stocks **(1 mark)** rather than increase output **(1 mark)** which may exacerbate the unemployment problem and lead to both hysteresis **(1 mark)** and further problems of demotivated "long-term" unemployment **(1 mark)**. Other issues include: Effects on inflation, balance of payments on current account, poverty, and investment.	**Up to 15 marks**
Use of diagrams to help support explanations, e.g. trade cycle, AD/AS	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 4 marks**
Reference to the UK and/or other economies.	**1 mark per reference to a maximum of 2 marks**

[15]

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12.

Response:	Max 4 marks
• includes evidence that shows that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • clearly explains how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services.	**4 marks**
• includes evidence that shows that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • unclear explanation of how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services..	**3 marks**
• includes evidence that shows that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • limited explanation of how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services.	**2 marks**
• includes evidence that does not clearly show that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • no explanation of how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services.	**1 mark**

Relevant issues include:

- biggest trade deficit £36, 733 million coincides with the fastest growth rate in GDP (3.4%) in 2007
- years of recession (negative growth in GDP) occur when the deficit on balance of trade in goods and services improves in both years (2008 and 2009)
- when growth picks up in 2010 (1.7% from -5.2% in 2009) the deficit on the balance of trade in goods and service deteriorates (£32 852 million from £23 373 million)
- why an increase in the rate of growth of GDP often leads to an increased deficit in the balance of trade in goods and services

[4]

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15.

Level of response	An answer that:	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or good use of data to support the response • includes well-focused analysis with a clear, logical chain of reasoning • includes a relevant diagram that will, at the top of this level, be accurate and used appropriately.	**7-9 marks**
2	• includes one or more issues that are relevant to the question • shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles and/or data to the question • includes some reasonable analysis but it might not be adequately developed and may be confused in places • may include a relevant diagram.	**4-6 marks**
1	• is very brief and/or lacks coherence • shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • demonstrates very limited ability to apply relevant economic principles and/or data to the question • may include some very limited analysis but the analysis lacks focus and/or becomes confused • may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects.	**1-3 marks**

An AD/AS diagram is expected, illustrating the possible effect of investment on AD and/or LRAS.
A PPF diagram could also be used.

Relevant issues include:

- definition of economic growth; what is meant by investment
- impact of investment on capital stock
- impact of investment on LRAS
- impact of investment on productive capacity
- impact of investment on productivity and efficiency
- impact of investment on AD and possible multiplier effects

[9]

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16. **The anticipated diagram would make appropriate use of diagrams, e.g. AD/AS, demand for labour, economic cycle.**

Relevant issues include:

- For a relevant explanation of an upturn in the economic cycle: An economic cycle shows the fluctuations in an economy's economic activity over time and an upturn usually refers to a recovery after a recession or slump and indicates that real national income is on the increase.
- If there is an increase in economic activity, it signals that firms are beginning to increase production which may lead to increased business confidence and could lead to increased investment due to the accelerator, seeing as though investment is a component of aggregate demand. This will cause aggregate demand to rise and due to the fact that firms will be producing more output, they will need to hire more workers as labour is a derived demand which will reduce cyclical unemployment leaving consumers with more disposable income and further rises in consumption, further reducing unemployment.

[9]

18. **The anticipated diagram would make appropriate use of diagrams, e.g. AD/AS, currency diagrams.**

Relevant issues include:

- For a relevant explanation of a devaluation of the exchange rate: An exchange rate is the value of one currency in terms of another and a devaluation is when a currency is lowered in value against another. This usually occurs in a fixed exchange rate system unlike a depreciation which is in a floating exchange rate system.
- Numerical example of a devaluation.
- As China devalues its currency, the value of the yuan falls in relation to the pound, therefore one pound buys more yuan. This makes imports from China relatively cheaper and exports from the UK to China relatively more expensive, thus the value of imports rises and the value of exports fall which are both components of aggregate demand causing aggregate demand to fall therefore reducing real national output and creating negative short-run economic growth.
- Effects on investment.
- Effects on business confidence.

[9]

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19.

Relevant issues include:

- definitions/explanations: government spending, taxation, economic activity
- explaining the different forms of government spending such as capital/current /transfers
- explaining the levels of government spending
- explaining the reasons for government spending i.e. the redistribution of income and wealth, merit good provision etc.
- explaining how changes in government spending and taxation can influence aggregate demand both directly and indirectly
- explaining discretionary policy
- explaining automatic stabilisers

- explaining the effects of the economic cycle on government spending and taxation
- explaining how changes in government spending could change aggregate supply such as:
  - capital spending on infrastructure
  - training and education
  - subsidies/grants for research and development
  - subsidies/grants for investment
  - tax credits
  - assisted childcare and the effects on labour supply
  - any other relevant point
- multiplier and possible accelerator effects
- explaining the different types of taxation
- explaining how changes in taxation could change aggregate supply such as:
  - reducing income tax creating incentives to work
  - reducing corporation tax allowing firms to retain more profit for investment
  - reducing taxation, possibly making UK firms more competitive abroad and effects on supply
  - using taxation (tariffs) as a form of protectionism, aiding domestic supply
  - any other relevant point.

The use of relevant diagrams such as AD/AS, or labour market diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

Note: Unless a candidate considers both government expenditure and taxation, they are unlikely to have 'developed a selection of key issues that are relevant to the question' and therefore unlikely to achieve level 3.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context **and/or** data to the question • might have some limited analysis but it may lack focus **and/or** become confused.	**1 – 5 marks**

[15]

20. B

[1]

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21.

Areas for discussion include:

- definitions/explanations: the balance of payments, the current account, current account deficit
- explaining the difference between a surplus or deficit on current account
- explaining the composition of the current account of the balance of payments
- explaining the historical experience of the UK's current account
- explaining the causes of deficits
- explain possible measures to reduce the deficit such as:
    - exchange rate manipulation
    - changes in interest rates potentially affecting the exchange rate
    - expenditure-reducing policies
    - expenditure-switching policies
    - the role of protectionism
    - government role in export promotion/trade deals
    - the role of fiscal and monetary policy
    - supply-side improvements which might begin to provide a solution to the weakness, such as:
        - competitiveness/unit labour costs
        - investment (human and physical capital)
        - technology, R&D and productivity
        - infrastructure
- consideration of the UK's membership of the WTO and EU restricting its ability to use protectionism
- consideration of whether the deficit is a problem if the capital account is in surplus
- consideration of the impact on other macroeconomic goals of trying to reduce the deficit on the current account of the balance of payments.

The use of relevant diagrams such as AD/AS diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21 – 25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16 – 20 marks**
3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these are not well-supported by arguments **and/or** data.	**11 – 15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context **and/or** data to the question • includes some limited analysis but it may lack focus **and/or** become confused • includes some evaluation which is weak and unsupported.	**6 – 10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which, at best, is very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

22. C

[1]

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23. **Relevant issues include:**

- definitions/explanations: economic growth, stable growth, LEDCs
- explaining the main characteristics of LEDCs with reference to measurements such as the HDI or GDP
- explaining factors that may be barriers to growth such as:
    - corruption
    - lack of property rights (both physical and intellectual)
    - poor infrastructure
    - a lack of, or poor quality, human capital
    - a lack of, or poor quality, physical capital
    - a lack of savings causing a lack of capital accumulation
    - institutional factors
    - primary product dependency
    - informal employment and a lack of tax revenue.

Note: some candidates may answer this question in terms of why MEDCs find it easier to achieve economic growth. This approach is fine and should be rewarded accordingly.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context **and/or** data to the question • might have some limited analysis but it may lack focus **and/or** become confused.	**1 – 5 marks**

[15]

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24.

Response	Max 4 marks
• includes evidence that shows that consumer confidence may have risen since 2014 • clearly explains how this data is evidence that consumer confidence may have risen since 2014.	**4 marks**
• includes evidence that shows that consumer confidence may have risen since 2014 • unclear explanation of how this data is evidence that consumer confidence may have risen since 2014.	**3 marks**
• includes some limited evidence that shows that consumer confidence may have risen since 2014 • limited explanation of how this data is evidence that consumer confidence may have risen since 2014.	**2 marks**
• includes evidence that does not clearly show that consumer confidence may have risen since 2014 • no explanation of how this data is evidence that consumer confidence may have risen since 2014.	**1 mark**

Relevant issues include:

- explanation of relevant terms such as saving ratio and consumer confidence
- explaining why the saving ratio may indicate consumer confidence
- explaining why the gross debt to income ratio is an indicator of consumer confidence
- the household gross debt to income ratio rose in 2014 to 141%, the first rise since 2011 indicating households were more willing to take on debt
- confidence may have been low before 2014, as household gross debt to income was falling from a high of about 168% in 2008 to a low of 140% in 2013 indicating households were reducing indebtedness
- forecast data for the household gross debt to income ratio indicate this will continue to rise until 2020 (to 162%) indicating households are expected to borrow more in the future
- the savings ratio fell in 2014 by 0.9 percentage points from 2012, but had a larger fall after 2014 by 1.3 percentage points in 2016 indicating a small rise in the marginal propensity to consume
- the lowest saving ratio was in 2016 at 7.1% indicating a peak in consumer confidence and willingness to consume
- confidence may have been low before 2014 as the savings ratio peaked in 2010 at 11.2% indicating household pessimism and a reluctance to spend.

[4]

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25. Calculation:
£26 300 × 0.071 = £1867.30 = £1867 to the nearest £

Response	Marks
For a correct answer (£1867) with the £ sign.	**2 marks**
For a correct answer but without the £ sign **and/or** not to the nearest £ (eg £1867.30).	**1 mark**

[2]

26. B

[1]

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